

Example 3. C is an associate for Z, a law firm in a metropolitan area. The normal working hours for C's law firm are from 9 a.m. until 6 p.m., but C's ordinary office hours are from 10 a.m. until 8 p.m. Public transportation, the only means of transportation available to C at the time C commutes from work to home during the evening, would be considered unsafe by a reasonable person. In response, Z hires a car service to take C home each evening. C does not receive annual compensation from Z in excess of the amount permitted by section 414(q)(1)(C) of the Code. However, C is treated as an employee exempt from the provisions of the FLSA and, accordingly, is not paid overtime wages. Therefore, C is not a qualified employee within the meaning of paragraph (k)(6) of this section. The value of the commute from work to home is includible in C's income by reference to fair market value.

(8) *Effective date.* This paragraph (k) applies to employer-provided transportation provided to a qualified employee on or after July 1, 1991.

[T.D. 8256, 54 FR 28582, July 6, 1989, as amended by T.D. 8389, 57 FR 1870, Jan. 16, 1992; T.D. 8457, 57 FR 62195, Dec. 30, 1992]

§ 1.61-22 Taxation of split-dollar life insurance arrangements.

(a) *Scope—(1) In general.* This section provides rules for the taxation of a split-dollar life insurance arrangement for purposes of the income tax, the gift tax, the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), the Railroad Retirement Tax Act (RRTA), and the Self-Employment Contributions Act of 1954 (SECA). For the Collection of Income Tax at Source on Wages, this section also provides rules for the taxation of a split-dollar life insurance arrangement, other than a payment under a split-dollar life insurance arrangement that is a split-dollar loan under § 1.7872-15(b)(1). A split-dollar life insurance arrangement (as defined in paragraph (b) of this section) is subject to the rules of paragraphs (d) through (g) of this section, § 1.7872-15, or general tax rules. For rules to determine which rules apply to a split-dollar life insurance arrangement, see paragraph (b)(3) of this section.

(2) *Overview.* Paragraph (b) of this section defines a split-dollar life insurance arrangement and provides rules to determine whether an arrangement is subject to the rules of paragraphs (d)

through (g) of this section, § 1.7872-15, or general tax rules. Paragraph (c) of this section defines certain other terms. Paragraph (d) of this section sets forth rules for the taxation of economic benefits provided under a split-dollar life insurance arrangement. Paragraph (e) of this section sets forth rules for the taxation of amounts received under a life insurance contract that is part of a split-dollar life insurance arrangement. Paragraph (f) of this section provides rules for additional tax consequences of a split-dollar life insurance arrangement, including the treatment of death benefit proceeds. Paragraph (g) of this section provides rules for the transfer of a life insurance contract (or an undivided interest in the contract) that is part of a split-dollar life insurance arrangement. Paragraph (h) of this section provides examples illustrating the application of this section. Paragraph (j) of this section provides the effective date of this section.

(b) *Split-dollar life insurance arrangement—(1) In general.* A split-dollar life insurance arrangement is any arrangement between an owner and a non-owner of a life insurance contract that satisfies the following criteria—

(i) Either party to the arrangement pays, directly or indirectly, all or any portion of the premiums on the life insurance contract, including a payment by means of a loan to the other party that is secured by the life insurance contract;

(ii) At least one of the parties to the arrangement paying premiums under paragraph (b)(1)(i) of this section is entitled to recover (either conditionally or unconditionally) all or any portion of those premiums and such recovery is to be made from, or is secured by, the proceeds of the life insurance contract; and

(iii) The arrangement is not part of a group-term life insurance plan described in section 79 unless the group-term life insurance plan provides permanent benefits to employees (as defined in § 1.79-0).

(2) *Special rule—(i) In general.* Any arrangement between an owner and a non-owner of a life insurance contract

is treated as a split-dollar life insurance arrangement (regardless of whether the criteria of paragraph (b)(1) of this section are satisfied) if the arrangement is described in paragraph (b)(2)(ii) or (iii) of this section.

(ii) *Compensatory arrangements.* An arrangement is described in this paragraph (b)(2)(ii) if the following criteria are satisfied—

(A) The arrangement is entered into in connection with the performance of services and is not part of a group-term life insurance plan described in section 79;

(B) The employer or service recipient pays, directly or indirectly, all or any portion of the premiums; and

(C) Either—

(1) The beneficiary of all or any portion of the death benefit is designated by the employee or service provider or is any person whom the employee or service provider would reasonably be expected to designate as the beneficiary; or

(2) The employee or service provider has any interest in the policy cash value of the life insurance contract.

(iii) *Shareholder arrangements.* An arrangement is described in this paragraph (b)(2)(iii) if the following criteria are satisfied—

(A) The arrangement is entered into between a corporation and another person in that person's capacity as a shareholder in the corporation;

(B) The corporation pays, directly or indirectly, all or any portion of the premiums; and

(C) Either—

(1) The beneficiary of all or any portion of the death benefit is designated by the shareholder or is any person whom the shareholder would reasonably be expected to designate as the beneficiary; or

(2) The shareholder has any interest in the policy cash value of the life insurance contract.

(3) *Determination of whether this section or § 1.7872-15 applies to a split-dollar life insurance arrangement—(i) Split-dollar life insurance arrangements involving split-dollar loans under § 1.7872-15.* Except as provided in paragraph (b)(3)(ii) of this section, paragraphs (d) through (g) of this section do not apply to any split-dollar loan as defined in § 1.7872-

15(b)(1). Section 1.7872-15 applies to any such loan. See paragraph (b)(5) of this section for the treatment of a payment made by a non-owner under a split-dollar life insurance arrangement if the payment is not a split-dollar loan.

(ii) *Exceptions.* Paragraphs (d) through (g) of this section apply (and § 1.7872-15 does not apply) to any split-dollar life insurance arrangement if—

(A) The arrangement is entered into in connection with the performance of services, and the employer or service recipient is the owner of the life insurance contract (or is treated as the owner of the contract under paragraph (c)(1)(ii)(A)(1) of this section); or

(B) The arrangement is entered into between a donor and a donee (for example, a life insurance trust) and the donor is the owner of the life insurance contract (or is treated as the owner of the contract under paragraph (c)(1)(ii)(A)(2) of this section).

(4) *Consistency requirement.* A split-dollar life insurance arrangement described in paragraph (b)(1) or (2) of this section must be treated in the same manner by the owner and the non-owner of the life insurance contract under either the rules of this section or § 1.7872-15. In addition, the owner and non-owner must fully account for all amounts under the arrangement under paragraph (b)(5) of this section, paragraphs (d) through (g) of this section, or § 1.7872-15.

(5) *Non-owner payments that are not split-dollar loans.* If a non-owner of a life insurance contract makes premium payments (directly or indirectly) under a split-dollar life insurance arrangement, and the payments are neither split-dollar loans nor consideration for economic benefits described in paragraph (d) of this section, then neither the rules of paragraphs (d) through (g) of this section nor the rules in § 1.7872-15 apply to such payments. Instead, general income tax, employment tax, self-employment tax, and gift tax principles apply to the premium payments. See, for example, § 1.61-2(d)(2)(ii)(A).

(6) *Waiver, cancellation, or forgiveness.* If a repayment obligation described in § 1.7872-15(a)(2) is waived, cancelled, or forgiven at any time, then the parties

must take the amount waived, cancelled, or forgiven into account in accordance with the relationships between the parties (for example, as compensation in the case of an employee-employer relationship).

(7) *Change in the owner.* If payments made by a non-owner to an owner were treated as split-dollar loans under §1.7872-15 and the split-dollar life insurance arrangement is modified such that, after the modification, the non-owner is the owner (within the meaning of paragraph (c)(1) of this section) of the life insurance contract under the arrangement, paragraphs (d) through (g) of this section apply to the split-dollar life insurance arrangement from the date of the modification. The payments made (both before and after the modification) are not treated as split-dollar loans under §1.7872-15 on or after the date of the modification. The non-owner of the life insurance contract under the modified split-dollar life insurance arrangement must fully take into account all economic benefits provided under the arrangement under paragraph (d) of this section on or after the date of the modification. For the treatment of a transfer of the contract when the unmodified arrangement is governed by paragraphs (d) through (g) of this section, see paragraph (g) of this section.

(c) *Definitions.* The following definitions apply for purposes of this section:

(1) *Owner*—(i) *In general.* With respect to a life insurance contract, the person named as the policy owner of such contract generally is the owner of such contract. If two or more persons are named as policy owners of a life insurance contract and each person has, at all times, all the incidents of ownership with respect to an undivided interest in the contract, each person is treated as the owner of a separate contract to the extent of such person's undivided interest. If two or more persons are named as policy owners of a life insurance contract but each person does not have, at all times, all the incidents of ownership with respect to an undivided interest in the contract, the person who is the first-named policy owner is treated as the owner of the entire contract.

(ii) *Special rule for certain arrangements*—(A) *In general.* Notwithstanding paragraph (c)(1)(i) of this section—

(1) An employer or service recipient is treated as the owner of a life insurance contract under a split-dollar life insurance arrangement that is entered into in connection with the performance of services if, at all times, the only economic benefit that will be provided under the arrangement is current life insurance protection as described in paragraph (d)(3) of this section; and

(2) A donor is treated as the owner of a life insurance contract under a split-dollar life insurance arrangement that is entered into between a donor and a donee (for example, a life insurance trust) if, at all times, the only economic benefit that will be provided under the arrangement is current life insurance protection as described in paragraph (d)(3) of this section.

(B) *Modifications.* If an arrangement described in paragraph (c)(1)(ii)(A) of this section is modified such that the arrangement is no longer described in paragraph (c)(1)(ii)(A) of this section, the following rules apply:

(1) If, immediately after such modification, the employer, service recipient, or donor is the owner of the life insurance contract under the split-dollar life insurance arrangement (determined without regard to paragraph (c)(1)(ii)(A) of this section), the employer, service recipient, or donor continues to be treated as the owner of the life insurance contract.

(2) If, immediately after such modification, the employer, service recipient, or donor is not the owner of the life insurance contract under the split-dollar life insurance arrangement (determined without regard to paragraph (c)(1)(ii)(A) of this section), the employer, service recipient, or donor is treated as having made a transfer of the entire life insurance contract to the employee, service provider, or donee under the rules of paragraph (g) of this section as of the date of such modification.

(3) For purposes of this paragraph (c)(1)(ii)(B), entering into a successor split-dollar life insurance arrangement that has the effect of providing any economic benefit in addition to that described in paragraph (d)(3) of this

section is treated as a modification of the prior split-dollar life insurance arrangement.

(iii) *Attribution rules for compensatory arrangements.* For purposes of this section, if a split-dollar life insurance arrangement is entered into in connection with the performance of services, the employer or service recipient is treated as the owner of the life insurance contract if the owner (within the meaning of paragraph (c)(1)(i) of this section) of the life insurance contract under the split-dollar life insurance arrangement is—

(A) A trust described in section 402(b);

(B) A trust that is treated as owned (within the meaning of sections 671 through 677) by the employer or the service recipient;

(C) A welfare benefit fund within the meaning of section 419(e)(1); or

(D) A member of the employer or service recipient's controlled group (within the meaning of section 414(b)) or a trade or business that is under common control with the employer or service recipient (within the meaning of section 414(c)).

(iv) *Life insurance contracts owned by partnerships.* [Reserved]

(2) *Non-owner*—(i) *Definition.* With respect to a life insurance contract, a non-owner is any person (other than the owner of such contract under paragraph (c)(1) of this section) that has any direct or indirect interest in such contract (but not including a life insurance company acting only in its capacity as the issuer of a life insurance contract).

(ii) *Example.* The following example illustrates the provisions of this paragraph (c)(2):

Example. (i) On January 1, 2009, Employer R and Trust T, an irrevocable life insurance trust that is not treated under sections 671 through 677 as owned by a grantor or other person, enter into a split-dollar life insurance arrangement in connection with the performance of services under which R will pay all the premiums on the life insurance contract until the termination of the arrangement or the death of E, an employee of R. C, the beneficiary of T, is E's child. R is the owner of the contract under paragraph (c)(1)(i) of this section. E is the insured under the life insurance contract. Upon termination of the arrangement or E's death, R is

entitled to receive the lesser of the aggregate premiums or the policy cash value of the contract and T will be entitled to receive any remaining amounts. Under the terms of the arrangement and applicable state law, the policy cash value is fully accessible by R and R's creditors but T has the right to borrow or withdraw at any time the portion of the policy cash value exceeding the amount payable to R.

(ii) Because E and T each have an indirect interest in the life insurance contract that is part of the split-dollar life insurance arrangement, each is a non-owner under paragraph (c)(2)(i) of this section. E and T each are provided economic benefits described in paragraph (d)(2) of this section pursuant to the split-dollar life insurance arrangement. Economic benefits are provided by owner R to E as a payment of compensation, and separately provided by E to T as a gift.

(3) *Transfer of entire contract or undivided interest therein.* A transfer of the ownership of a life insurance contract (or an undivided interest in such contract) that is part of a split-dollar life insurance arrangement occurs on the date that a non-owner becomes the owner (within the meaning of paragraph (c)(1) of this section) of the entire contract or of an undivided interest in the contract.

(4) *Undivided interest.* An undivided interest in a life insurance contract consists of an identical fractional or percentage interest or share in each right, benefit, and obligation with respect to the contract. In the case of any arrangement purporting to create undivided interests where, in substance, the rights, benefits or obligations are shared to any extent among the holders of such interests, the arrangement will be treated as a split-dollar life insurance arrangement.

(5) *Employment tax.* The term employment tax means any tax imposed by, or collected under, the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), the Railroad Retirement Tax Act (RRTA), and the Collection of Income Tax at Source on Wages.

(6) *Self-employment tax.* The term self-employment tax means the tax imposed by the Self-Employment Contributions Act of 1954 (SECA).

(d) *Economic benefits provided under a split-dollar life insurance arrangement*—
(1) *In general.* In the case of a split-dollar life insurance arrangement subject

to the rules of paragraphs (d) through (g) of this section, economic benefits are treated as being provided to the non-owner of the life insurance contract. The non-owner (and the owner for gift and employment tax purposes) must take into account the full value of all economic benefits described in paragraph (d)(2) of this section, reduced by the consideration paid directly or indirectly by the non-owner to the owner for those economic benefits. Depending on the relationship between the owner and the non-owner, the economic benefits may constitute a payment of compensation, a distribution under section 301, a contribution to capital, a gift, or a transfer having a different tax character. Further, depending on the relationship between or among a non-owner and one or more other persons (including a non-owner or non-owners), the economic benefits may be treated as provided from the owner to the non-owner and as separately provided from the non-owner to such other person or persons (for example, as a payment of compensation from an employer to an employee and as a gift from the employee to the employee's child).

(2) *Value of economic benefits.* The value of the economic benefits provided to a non-owner for a taxable year under the arrangement equals—

(i) The cost of current life insurance protection provided to the non-owner as determined under paragraph (d)(3) of this section;

(ii) The amount of policy cash value to which the non-owner has current access within the meaning of paragraph (d)(4)(ii) of this section (to the extent that such amount was not actually taken into account for a prior taxable year); and

(iii) The value of any economic benefits not described in paragraph (d)(2)(i) or (ii) of this section provided to the non-owner (to the extent not actually taken into account for a prior taxable year).

(3) *Current life insurance protection—*
(i) *Amount of current life insurance protection.* In the case of a split-dollar life insurance arrangement described in paragraph (d)(1) of this section, the amount of the current life insurance protection provided to the non-owner

for a taxable year (or any portion thereof in the case of the first year or the last year of the arrangement) equals the excess of the death benefit of the life insurance contract (including paid-up additions thereto) over the total amount payable to the owner (including any outstanding policy loans that offset amounts otherwise payable to the owner) under the split-dollar life insurance arrangement, less the portion of the policy cash value actually taken into account under paragraph (d)(1) of this section or paid for by the non-owner under paragraph (d)(1) of this section for the current taxable year or any prior taxable year.

(ii) *Cost of current life insurance protection.* The cost of current life insurance protection provided to the non-owner for any year (or any portion thereof in the case of the first year or the last year of the arrangement) equals the amount of the current life insurance protection provided to the non-owner (determined under paragraph (d)(3)(i) of this section) multiplied by the life insurance premium factor designated or permitted in guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii) of this chapter).

(4) *Policy cash value—*(i) *In general.* For purposes of this paragraph (d), policy cash value is determined disregarding surrender charges or other similar charges or reductions. Policy cash value includes policy cash value attributable to paid-up additions.

(ii) *Current access.* For purposes of this paragraph (d), a non-owner has current access to that portion of the policy cash value—

(A) To which, under the arrangement, the non-owner has a current or future right; and

(B) That currently is directly or indirectly accessible by the non-owner, inaccessible to the owner, or inaccessible to the owner's general creditors.

(5) *Valuation date—*(i) *General rules.* For purposes of this paragraph (d), the amount of the current life insurance protection and the policy cash value shall be determined on the same valuation date. The valuation date is the last day of the non-owner's taxable year, unless the owner and non-owner

agree to instead use the policy anniversary date as the valuation date. Notwithstanding the previous sentence, if the split-dollar life insurance arrangement terminates during the taxable year of the non-owner, the value of such economic benefits is determined on the day that the arrangement terminates.

(ii) *Consistency requirement.* The owner and non-owner of the split-dollar life insurance arrangement must use the same valuation date. In addition, the same valuation date must be used for all years prior to termination of the split-dollar life insurance arrangement unless the parties receive consent of the Commissioner to change the valuation date.

(iii) *Artifice or device.* Notwithstanding paragraph (d)(5)(i) of this section, if any artifice or device is used to understate the amount of any economic benefit on the valuation date in paragraph (d)(5)(i) of this section, then, for purposes of this paragraph (d), the date on which the amount of the economic benefit is determined is the date on which the amount of the economic benefit is greatest during that taxable year.

(iv) *Special rule for certain taxes.* For purposes of employment tax (as defined in paragraph (c)(5) of this section), self-employment tax (as defined in paragraph (c)(6) of this section), and sections 6654 and 6655 (relating to the failure to pay estimated income tax), the portions of the current life insurance protection and the policy cash value that are treated as provided by the owner to the non-owner shall be treated as so provided on the last day of the taxable year of the non-owner. Notwithstanding the previous sentence, if the split-dollar life insurance arrangement terminates during the taxable year of the non-owner, such portions of the current life insurance protection and the policy cash value shall be treated as so provided on the day that the arrangement terminates.

(6) *Examples.* The following examples illustrate the rules of this paragraph (d). Except as otherwise provided, both examples assume the following facts: employer (R) is the owner (as defined in paragraph (c)(1)(i) of this section) and employee (E) is the non-owner (as

defined in paragraph (c)(2)(i) of this section) of a life insurance contract that is part of a split-dollar life insurance arrangement that is subject to the provisions of paragraphs (d) through (g) of this section; the contract is a life insurance contract as defined in section 7702 and not a modified endowment contract as defined in section 7702A; R does not withdraw or obtain a loan of any portion of the policy cash value and does not surrender any portion of the life insurance contract; the compensation paid to E is reasonable; E is not provided any economic benefits described in paragraph (d)(2)(iii) of this section; E does not make any premium payments; E's taxable year is the calendar year; the value of the economic benefits is determined on the last day of E's taxable year; and E reports on E's Federal income tax return for each year that the split-dollar life insurance arrangement is in effect the amount of income required to be reported under paragraph (d) of this section. The examples are as follows:

Example 1. (i) *Facts.* On January 1 of year 1, R and E enter into the split-dollar life insurance arrangement. Under the arrangement, R pays all of the premiums on the life insurance contract until the termination of the arrangement or E's death. The arrangement provides that upon termination of the arrangement or E's death, R is entitled to receive the lesser of the aggregate premiums paid or the policy cash value of the contract and E is entitled to receive any remaining amounts. Under the terms of the arrangement and applicable state law, the policy cash value is fully accessible by R and R's creditors but E has the right to borrow or withdraw at any time the portion of the policy cash value exceeding the amount payable to R. To fund the arrangement, R purchases a life insurance contract with constant death benefit protection equal to \$1,500,000. R makes premium payments on the life insurance contract of \$60,000 in each of years 1, 2, and 3. The policy cash value equals \$55,000 as of December 31 of year 1, \$140,000 as of December 31 of year 2, and \$240,000 as of December 31 of year 3.

(ii) *Analysis.* Under the terms of the split-dollar life insurance arrangement, E has the right for year 1 and all subsequent years to borrow or withdraw the portion of the policy cash value exceeding the amount payable to R. Thus, under paragraph (d)(4)(ii) of this section, E has current access to such portion of the policy cash value for each year that

the arrangement is in effect. In addition, because R pays all of the premiums on the life insurance contract, R provides to E all of the economic benefits that E receives under the arrangement. Therefore, under paragraph (d)(1) of this section, E includes in gross income the value of all economic benefits described in paragraphs (d)(2)(i) and (ii) of this section provided to E under the arrangement.

(iii) *Results for year 1.* For year 1, E is provided, under paragraph (d)(2)(ii) of this section, \$0 of policy cash value (excess of \$55,000 policy cash value determined as of December 31 of year 1 over \$55,000 payable to R). For year 1, E is also provided, under paragraph (d)(2)(i) of this section, current life insurance protection of \$1,445,000 (\$1,500,000 minus \$55,000 payable to R). Thus, E includes in gross income for year 1 the cost of \$1,445,000 of current life insurance protection.

(iv) *Results for year 2.* For year 2, E is provided, under paragraph (d)(2)(ii) of this section, \$20,000 of policy cash value (\$140,000 policy cash value determined as of December 31 of year 2 minus \$120,000 payable to R). For year 2, E is also provided, under paragraph (d)(2)(i) of this section, current life insurance protection of \$1,360,000 (\$1,500,000 minus the sum of \$120,000 payable to R and the aggregate of \$20,000 of policy cash value that E actually includes in income on E's year 1 and year 2 federal income tax returns). Thus, E includes in gross income for year 2 the sum of \$20,000 of policy cash value and the cost of \$1,360,000 of current life insurance protection.

(v) *Results for year 3.* For year 3, E is provided, under paragraph (d)(2)(ii) of this section, \$40,000 of policy cash value (\$240,000 policy cash value determined as of December 31 of year 3 minus the sum of \$180,000 payable to R and \$20,000 of aggregate policy cash value that E actually included in gross income on E's year 1 and year 2 federal income tax returns). For year 3, E is also provided, under paragraph (d)(2)(i) of this section, current life insurance protection of \$1,260,000 (\$1,500,000 minus the sum of \$180,000 payable to R and \$60,000 of aggregate policy cash value that E actually includes in gross income on E's year 1, year 2, and year 3 federal income tax returns). Thus, E includes in gross income for year 3 the sum of \$40,000 of policy cash value and the cost of \$1,260,000 of current life insurance protection.

Example 2. (i) *Facts.* The facts are the same as in *Example 1* except that E cannot directly or indirectly access any portion of the policy cash value, but the terms of the split-dollar life insurance arrangement or applicable state law provide that the policy cash value in excess of the amount payable to R is inaccessible to R's general creditors.

(ii) *Analysis.* Under the terms of the split-dollar life insurance arrangement or applicable state law, the portion of the policy cash

value exceeding the amount payable to R is inaccessible to R's general creditors and E has a current or future right to that portion of the cash value. Thus, under paragraph (d)(4)(ii) of this section, E has current access to such portion of the policy cash value for each year that the arrangement is in effect. In addition, because R pays all of the premiums on the life insurance contract, R provides to E all of the economic benefits that E receives under the arrangement. Therefore, under paragraph (d)(1) of this section, E includes in gross income the value of all economic benefits described in paragraphs (d)(2)(i) and (ii) of this section provided to E under the arrangement.

(iii) *Results for years 1, 2 and 3.* The results for this example are the same as the results in *Example 1*.

(e) *Amounts received under the contract—(1) In general.* Except as otherwise provided in paragraph (f)(3) of this section, any amount received under a life insurance contract that is part of a split-dollar life insurance arrangement subject to the rules of paragraphs (d) through (g) of this section (including, but not limited to, a policy owner dividend, proceeds of a specified policy loan described in paragraph (e)(2) of this section, or the proceeds of a withdrawal from or partial surrender of the life insurance contract) is treated, to the extent provided directly or indirectly to a non-owner of the life insurance contract, as though such amount had been paid to the owner of the life insurance contract and then paid by the owner to the non-owner. The amount received is taxable to the owner in accordance with the rules of section 72. The non-owner (and the owner for gift tax and employment tax purposes) must take the amount described in paragraph (e)(3) of this section into account as a payment of compensation, a distribution under section 301, a contribution to capital, a gift, or other transfer depending on the relationship between the owner and the non-owner.

(2) *Specified policy loan.* A policy loan is a specified policy loan to the extent—

(i) The proceeds of the loan are distributed directly from the insurance company to the non-owner;

(ii) A reasonable person would not expect that the loan will be repaid by the non-owner; or

(iii) The non-owner's obligation to repay the loan to the owner is satisfied or is capable of being satisfied upon repayment by either party to the insurance company.

(3) *Amount required to be taken into account.* With respect to a non-owner (and the owner for gift tax and employment tax purposes), the amount described in this paragraph (e)(3) is equal to the excess of—

(i) The amount treated as received by the owner under paragraph (e)(1) of this section; over

(ii) The amount of all economic benefits described in paragraphs (d)(2)(ii) and (iii) of this section actually taken into account by the non-owner (and the owner for gift tax and employment tax purposes) plus any consideration described in paragraph (d)(1) of this section paid by the non-owner for such economic benefits described in paragraphs (d)(2)(ii) and (iii) of this section. The amount determined under the preceding sentence applies only to the extent that neither this paragraph (e)(3)(ii) nor paragraph (g)(1)(ii) of this section previously has applied to such economic benefits.

(f) *Other tax consequences—(1) Introduction.* In the case of a split-dollar life insurance arrangement subject to the rules of paragraphs (d) through (g) of this section, this paragraph (f) sets forth other tax consequences to the owner and non-owner of a life insurance contract that is part of the arrangement for the period prior to the transfer (as defined in paragraph (c)(3) of this section) of the contract (or an undivided interest therein) from the owner to the non-owner. See paragraph (g) of this section and § 1.83-6(a)(5) for tax consequences upon the transfer of the contract (or an undivided interest therein).

(2) *Investment in the contract—(i) To the non-owner.* A non-owner does not receive any investment in the contract under section 72(e)(6) with respect to a life insurance contract that is part of a split-dollar life insurance arrangement subject to the rules of paragraphs (d) through (g) of this section.

(ii) *To owner.* Any premium paid by an owner under a split-dollar life insurance arrangement subject to the rules of paragraphs (d) through (g) of this

section is included in the owner's investment in the contract under section 72(e)(6). No premium or amount described in paragraph (d) of this section is deductible by the owner (except as otherwise provided in § 1.83-6(a)(5)). Any amount paid by a non-owner, directly or indirectly, to the owner of the life insurance contract for current life insurance protection or for any other economic benefit under the life insurance contract is included in the owner's gross income and is included in the owner's investment in the life insurance contract for purposes of section 72(e)(6) (but only to the extent not otherwise so included by reason of having been paid by the owner as a premium or other consideration for the contract).

(3) *Treatment of death benefit proceeds—(i) Death benefit proceeds to beneficiary (other than the owner).* Any amount paid to a beneficiary (other than the owner) by reason of the death of the insured is excluded from gross income by such beneficiary under section 101(a) as an amount received under a life insurance contract to the extent such amount is allocable to current life insurance protection provided to the non-owner pursuant to the split-dollar life insurance arrangement, the cost of which was paid by the non-owner, or the value of which the non-owner actually took into account pursuant to paragraph (d)(1) of this section.

(ii) *Death benefit proceeds to owner as beneficiary.* Any amount paid or payable to an owner in its capacity as a beneficiary by reason of the death of the insured is excluded from gross income of the owner under section 101(a) as an amount received under a life insurance contract to the extent such amount is not allocable to current life insurance protection provided to the non-owner pursuant to the split-dollar life insurance arrangement, the cost of which was paid by the non-owner, or the value of which the non-owner actually took into account pursuant to paragraph (d)(1) of this section.

(iii) *Transfers of death benefit proceeds.* Death benefit proceeds paid to a party to a split-dollar life insurance arrangement (or the estate or beneficiary of that party) that are not excludable from that party's income under section

101(a) to the extent provided in paragraph (f)(3)(i) or (ii) of this section, are treated as transferred to that party in a separate transaction. The death benefit proceeds treated as so transferred will be taxed in a manner similar to other transfers. For example, if death benefit proceeds paid to an employee, the employee's estate, or the employee's beneficiary are not excludable from the employee's gross income under section 101(a) to the extent provided in paragraph (f)(3)(i) of this section, then such payment is treated as a payment of compensation by the employer to the employee.

(g) *Transfer of entire contract or undivided interest therein*—(1) *In general.* Upon a transfer within the meaning of paragraph (c)(3) of this section of a life insurance contract (or an undivided interest therein) to a non-owner (transferee), the transferee (and the owner (transferor) for gift tax and employment tax purposes) takes into account the excess of the fair market value of the life insurance contract (or the undivided interest therein) transferred to the transferee at that time over the sum of—

(i) The amount the transferee pays to the transferor to obtain the contract (or the undivided interest therein); and

(ii) The amount of all economic benefits described in paragraph (d)(2)(ii) and (iii) of this section actually taken into account by the transferee (and the transferor for gift tax and employment tax purposes), plus any consideration described in paragraph (d)(1) of this section paid by the transferee for such economic benefits described in paragraphs (d)(2)(ii) and (iii) of this section. The amount determined under the preceding sentence applies only to the extent that neither this paragraph (g)(1)(ii) nor paragraph (e)(3)(ii) of this section previously has applied to such economic benefits.

(2) *Determination of fair market value.* For purposes of paragraph (g)(1) of this section, the fair market value of a life insurance contract is the policy cash value and the value of all other rights under such contract (including any supplemental agreements thereto and whether or not guaranteed), other than the value of current life insurance protection. Notwithstanding the preceding

sentence, the fair market value of a life insurance contract for gift tax purposes is determined under § 25.2512-6(a) of this chapter.

(3) *Exception for certain transfers in connection with the performance of services.* To the extent the ownership of a life insurance contract (or undivided interest in such contract) is transferred in connection with the performance of services, paragraph (g)(1) of this section does not apply until such contract (or undivided interest in such contract) is taxable under section 83. For purposes of paragraph (g)(1) of this section, fair market value is determined disregarding any lapse restrictions and at the time the transfer of such contract (or undivided interest in such contract) is taxable under section 83.

(4) *Treatment of non-owner after transfer*—(i) *In general.* After a transfer of an entire life insurance contract (except when such transfer is in connection with the performance of services and the transfer is not yet taxable under section 83), the person who previously had been the non-owner is treated as the owner of such contract for all purposes, including for purposes of paragraph (b) of this section and for purposes of § 1.61-2(d)(2)(ii)(A). After the transfer of an undivided interest in a life insurance contract (or, if later, at the time such transfer is taxable under section 83), the person who previously had been the non-owner is treated as the owner of a separate contract consisting of that interest for all purposes, including for purposes of paragraph (b) of this section and for purposes of § 1.61-2(d)(2)(ii)(A).

(ii) *Investment in the contract after transfer*—(A) *In general.* The amount treated as consideration paid to acquire the contract under section 72(g)(1), in order to determine the aggregate premiums paid by the transferee for purposes of section 72(e)(6)(A) after the transfer (or, if later, at the time such transfer is taxable under section 83), equals the greater of the fair market value of the contract or the sum of the amounts determined under paragraphs (g)(1)(i) and (ii) of this section.

(B) *Transfers between a donor and a donee.* In the case of a transfer of a contract between a donor and a donee, the amount treated as consideration paid by the transferee to acquire the contract under section 72(g)(1), in order to determine the aggregate premiums paid by the transferee for purposes of section 72(e)(6)(A) after the transfer, equals the sum of the amounts determined under paragraphs (g)(1)(i) and (ii) of this section except that—

(1) The amount determined under paragraph (g)(1)(i) of this section includes the aggregate of premiums or other consideration paid or deemed to have been paid by the transferor; and

(2) The amount of all economic benefits determined under paragraph (g)(1)(ii) of this section actually taken into account by the transferee does not include such benefits to the extent such benefits were excludable from the transferee's gross income at the time of receipt.

(C) *Transfers of an undivided interest in a contract.* If a portion of a contract is transferred to the transferee, then the amount to be included as consideration paid to acquire the contract is determined by multiplying the amount determined under paragraph (g)(4)(ii)(A) of this section (as modified by paragraph (g)(4)(ii)(B) of this section, if the transfer is between a donor and a donee) by a fraction, the numerator of which is the fair market value of the portion transferred and the denominator of which is the fair market value of the entire contract.

(D) *Example.* The following example illustrates the rules of this paragraph (g)(4)(ii):

Example. (i) In year 1, donor D and donee E enter into a split-dollar life insurance arrangement as defined in paragraph (b)(1) of this section. D is the owner of the life insurance contract under paragraph (c)(1) of this section. The life insurance contract is not a modified endowment contract as defined in section 7702A. In year 5, D gratuitously transfers the contract, within the meaning of paragraph (c)(3) of this section, to E. At the time of the transfer, the fair market value of the contract is \$200,000 and D had paid \$50,000 in premiums under the arrangement. In addition, by the time of the transfer, E had current access to \$80,000 of policy cash value which was excludable from E's gross income under section 102.

(ii) E's investment in the contract is \$50,000, consisting of the \$50,000 of premiums paid by D. The \$80,000 of policy cash value to which E had current access is not included in E's investment in the contract because such amount was excludable from E's gross income when E had current access to that policy cash value.

(iii) *No investment in the contract for current life insurance protection.* Except as provided in paragraph (g)(4)(ii)(B) of this section, no amount allocable to current life insurance protection provided to the transferee (the cost of which was paid by the transferee or the value of which was provided to the transferee) is treated as consideration paid to acquire the contract under section 72(g)(1) to determine the aggregate premiums paid by the transferee for purposes of determining the transferee's investment in the contract under section 72(e) after the transfer.

(h) *Examples.* The following examples illustrate the rules of this section. Except as otherwise provided, each of the examples assumes that the employer (R) is the owner (as defined in paragraph (c)(1) of this section) of a life insurance contract that is part of a split-dollar life insurance arrangement subject to the rules of paragraphs (d) through (g) of this section, that the employee (E) is not provided any economic benefits described in paragraph (d)(2)(iii) of this section, that the life insurance contract is not a modified endowment contract under section 7702A, that the compensation paid to E is reasonable, and that E makes no premium payments. The examples are as follows:

Example 1. (i) In year 1, R purchases a life insurance contract on the life of E. R is named as the policy owner of the contract. R and E enter into an arrangement under which R will pay all the premiums on the life insurance contract until the termination of the arrangement or E's death. Upon termination of the arrangement or E's death, R is entitled to receive the greater of the aggregate premiums or the policy cash value of the contract. The balance of the death benefit will be paid to a beneficiary designated by E.

(ii) Because R is designated as the policy owner of the contract, R is the owner of the contract under paragraph (c)(1)(i) of this section. In addition, R would be treated as the owner of the contract regardless of whether R were designated as the policy owner under

paragraph (c)(1)(i) of this section because the split-dollar life insurance arrangement is described in paragraph (c)(1)(ii)(A)(I) of this section. E is a non-owner of the contract. Under the arrangement between R and E, a portion of the death benefit is payable to a beneficiary designated by E. The arrangement is a split-dollar life insurance arrangement under paragraph (b)(1) or (2) of this section. Because R pays all the premiums on the life insurance contract, R provides to E the entire amount of the current life insurance protection E receives under the arrangement. Therefore, for each year that the split-dollar life insurance arrangement is in effect, E must include in gross income under paragraph (d)(1) of this section the value of current life insurance protection described in paragraph (d)(2)(i) of this section provided to E in each year.

Example 2. (i) The facts are the same as in *Example 1* except that, upon termination of the arrangement or E's death, R is entitled to receive the lesser of the aggregate premiums or the policy cash value of the contract. Under the terms of the arrangement and applicable state law, the policy cash value is fully accessible by R and R's creditors but E has the right to borrow or withdraw at any time the portion of the policy cash value exceeding the amount payable to R.

(ii) Because R is designated as the policy owner, R is the owner of the contract under paragraph (c)(1)(i) of this section. E is a non-owner of the contract. For each year that the split-dollar life insurance arrangement is in effect, E has the right to borrow or withdraw at any time the portion of the policy cash value exceeding the amount payable to R. Thus, under paragraph (d)(4)(ii) of this section, E has current access to such portion of the policy cash value for each year that the arrangement is in effect. In addition, because R pays all the premiums on the life insurance contract, R provides to E all the economic benefits that E receives under the arrangement. Therefore, for each year that the split-dollar life insurance arrangement is in effect, E must include in gross income under paragraph (d)(1) of this section, the value of all economic benefits described in paragraph (d)(2)(i) and (ii) of this section provided to E in each year.

Example 3. (i) The facts are the same as in *Example 1* except that in year 5, R and E modify the split-dollar life insurance arrangement to provide that, upon termination of the arrangement or E's death, R is entitled to receive the greater of the aggregate premiums or one-half the policy cash value of the contract. Under the terms of the modified arrangement and applicable state law, the policy cash value is fully accessible by R and R's creditors but E has the right to borrow or withdraw at any time the portion of

the policy cash value exceeding the amount payable to R.

(ii) For each year that the split-dollar life insurance arrangement is in effect, E must include in gross income under paragraph (d)(1) of this section the value of the economic benefits described in paragraph (d)(2)(i) of this section provided to E under the arrangement during that year. In year 5 (and subsequent years), E has the right to borrow or withdraw at any time the portion of the policy cash value exceeding the amount payable to R. Thus, under paragraph (d)(4)(ii) of this section, E has current access to such portion of the policy cash value. Thus, in year 5 (and each subsequent year), E must also include in gross income under paragraph (d)(1) of this section the value of the economic benefits described in paragraph (d)(2)(ii) of this section provided to E in each year.

(iii) The arrangement is not described in paragraph (c)(1)(ii)(A)(I) of this section after it is modified in year 5. Because R is the designated owner of the life insurance contract, R continues to be treated as the owner of the contract under paragraph (c)(1)(ii)(B)(I) of this section after the arrangement is modified. In addition, because the modification made by R and E in year 5 does not involve the transfer (within the meaning of paragraph (c)(3) of this section) of an undivided interest in the life insurance contract from R to E, the modification is not a transfer for purposes of paragraph (g) of this section.

Example 4. (i) The facts are the same as in *Example 2* except that in year 7, R and E modify the split-dollar life insurance arrangement to provide that, upon termination of the arrangement or E's death, R will be paid the lesser of 80 percent of the aggregate premiums or the policy cash value of the contract. Under the terms of the modified arrangement and applicable state law, the policy cash value is fully accessible by R and R's creditors but E has the right to borrow or withdraw at any time the portion of the policy cash value exceeding the lesser of 80 percent of the aggregate premiums paid by R or the policy cash value of the contract.

(ii) Commencing in year 7 (and in each subsequent year), E must include in gross income the economic benefits described in paragraph (d)(2)(ii) of this section as provided in this *Example 4(ii)* rather than as provided in *Example 2(ii)*. Thus, in year 7 (and in each subsequent year) E must include in gross income under paragraph (d) of this section, the excess of the policy cash value over the lesser of 80 percent of the aggregate premiums paid by R or the policy cash value of the contract (to the extent E did not actually include such amounts in gross income for a prior taxable year). In addition, in year 7 (and each subsequent year) E must also include in gross income the value of the economic benefits described in paragraph

(d)(2)(i) of this section provided to E under the arrangement in each such year.

Example 5. (i) The facts are the same as in *Example 3* except that in year 7, E is designated as the policy owner. At that time, E's rights to the contract are substantially vested as defined in § 1.83-3(b).

(ii) In year 7, R is treated as having made a transfer (within the meaning of paragraph (c)(3) of this section) of the life insurance contract to E. E must include in gross income the amount determined under paragraph (g)(1) of this section.

(iii) After the transfer of the contract to E, E is the owner of the contract and any premium payments by R will be included in E's income under paragraph (b)(5) of this section and § 1.61-2(d)(2)(ii)(A) (unless R's payments are split-dollar loans as defined in § 1.7872-15(b)(1)).

Example 6. (i) In year 1, E and R enter into a split-dollar life insurance arrangement as defined in paragraph (b)(2) of this section. Under the arrangement, R is required to make annual premium payments of \$10,000 and E is required to make annual premium payments of \$500. In year 5, a \$500 policy owner dividend payable to E is declared by the insurance company. E directs the insurance company to use the \$500 as E's premium payment for year 5.

(ii) For each year the arrangement is in effect, E must include in gross income the value of the economic benefits provided during the year, as required by paragraph (d)(2) of this section, over the \$500 premium payments paid by E. In year 5, E must also include in gross income as compensation the excess, if any, of the \$500 distributed to E from the proceeds of the policy owner dividend over the amount determined under paragraph (e)(3)(ii) of this section.

(iii) R must include in income the premiums paid by E during the years the split-dollar life insurance arrangement is in effect, including the \$500 of the premium E paid in year 5 with proceeds of the policy owner dividend. R's investment in the contract is increased in an amount equal to the premiums paid by E, including the \$500 of the premium paid by E in year 5 from the proceeds of the policy owner dividend. In year 5, R is treated as receiving a \$500 distribution under the contract, which is taxed pursuant to section 72.

Example 7. (i) The facts are the same as in *Example 2* except that in year 10, E withdraws \$100,000 from the cash value of the contract.

(ii) In year 10, R is treated as receiving a \$100,000 distribution from the insurance company. This amount is treated as an amount received by R under the contract and taxed pursuant to section 72. This amount reduces R's investment in the contract under section 72(e). R is treated as paying the \$100,000 to E as cash compensation, and E must include that amount in gross income less any

amounts determined under paragraph (e)(3)(ii) of this section.

Example 8. (i) The facts are the same as in *Example 7* except E receives the proceeds of a \$100,000 specified policy loan directly from the insurance company.

(ii) The transfer of the proceeds of the specified policy loan to E is treated as a loan by the insurance company to R. Under the rules of section 72(e), the \$100,000 loan is not included in R's income and does not reduce R's investment in the contract. R is treated as paying the \$100,000 of loan proceeds to E as cash compensation. E must include that amount in gross income less any amounts determined under paragraph (e)(3)(ii) of this section.

(i) [Reserved]

(j) *Effective date—(1) General rule—(i) In general.* This section applies to any split-dollar life insurance arrangement (as defined in paragraph (b)(1) or (2) of this section) entered into after September 17, 2003.

(ii) *Determination of when an arrangement is entered into.* For purposes of paragraph (j) of this section, a split-dollar life insurance arrangement is entered into on the latest of the following dates:

(A) The date on which the life insurance contract under the arrangement is issued;

(B) The effective date of the life insurance contract under the arrangement;

(C) The date on which the first premium on the life insurance contract under the arrangement is paid;

(D) The date on which the parties to the arrangement enter into an agreement with regard to the policy; or

(E) The date on which the arrangement satisfies the definition of a split-dollar life insurance arrangement (as defined in paragraph (b)(1) or (2) of this section).

(2) *Modified arrangements treated as new arrangements—(i) In general.* For purposes of paragraph (j)(1) of this section, if an arrangement entered into on or before September 17, 2003, the arrangement is treated as a new arrangement entered into on the date of the modification.

(ii) *Non-material modifications.* The following is a non-exclusive list of changes that are not material modifications under paragraph (j)(2)(i) of

this section (either alone or in conjunction with other changes listed in paragraphs (j)(2)(ii)(A) through (I) of this section)—

(A) A change solely in the mode of premium payment (for example, a change from monthly to quarterly premiums);

(B) A change solely in the beneficiary of the life insurance contract, unless the beneficiary is a party to the arrangement;

(C) A change solely in the interest rate payable under the life insurance contract on a policy loan;

(D) A change solely necessary to preserve the status of the life insurance contract under section 7702;

(E) A change solely to the ministerial provisions of the life insurance contract (for example, a change in the address to send payment);

(F) A change made solely under the terms of any agreement (other than the life insurance contract) that is a part of the split-dollar life insurance arrangement if the change is non-discretionary by the parties and is made pursuant to a binding commitment (whether set forth in the agreement or otherwise) in effect on or before September 17, 2003;

(G) A change solely in the owner of the life insurance contract as a result of a transaction to which section 381(a) applies and in which substantially all of the former owner's assets are transferred to the new owner of the policy;

(H) A change to the policy solely if such change is required by a court or a state insurance commissioner as a result of the insolvency of the insurance company that issued the policy; or

(I) A change solely in the insurance company that administers the policy as a result of an assumption reinsurance transaction between the issuing insurance company and the new insurance company to which the owner and the non-owner were not a party.

(iii) *Delegation to Commissioner.* The Commissioner, in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin, may provide additional guidance with respect to other modifications that are not material for purposes of paragraph

(j)(2)(i) of this section. See § 601.601(d)(2)(ii) of this chapter.

[T.D. 9092, 68 FR 54344, Sept. 17, 2003; 68 FR 63735, Nov. 10, 2003]

§ 1.62-1 Adjusted gross income.

(a)-(b) [Reserved]

(c) *Deductions allowable in computing adjusted gross income.* The deductions specified in section 62(a) for purposes of computing adjusted gross income are—

(1) Deductions set forth in § 1.62-1T(c); and

(2) Deductions allowable under part VI, subchapter B, chapter 1 of the Internal Revenue Code, (section 161 and following) that consist of expenses paid or incurred by the taxpayer in connection with the performance of services as an employee under a reimbursement or other expense allowance arrangement (as defined in § 1.62-2) with his or her employer. For the rules pertaining to expenses paid or incurred in taxable years beginning before January 1, 1989, see § 1.62-1T (c)(2) and (f) (as contained in 26 CFR part 1 (§§ 1.61 to 1.169) revised April 1, 1992).

(d) through (h) [Reserved]

(i) *Effective date.* Paragraph (c) of this section is effective for taxable years beginning on or after January 1, 1989.

[T.D. 8451, 57 FR 57668, Dec. 7, 1992; 57 FR 60568, Dec. 21, 1992]

§ 1.62-1T Adjusted gross income (temporary).

(a) *Basis for determining the amount of certain deductions.* The term “adjusted gross income” means the gross income computed under section 61 minus such of the deductions allowed by chapter 1 of the Code as are specified in section 62(a). Adjusted gross income is used as the basis for determining the following:

(1) The limitation on the amount of miscellaneous itemized deductions (under section 67).

(2) The limitation on the amount of the deduction for casualty losses (under section 165(h)(2)).

(3) The limitation on the amount of the deduction for charitable contributions (under section 170(b)(1)).

(4) The limitation on the amount of the deduction for medical and dental expenses (under section 213).

(5) The limitation on the amount of the deduction for qualified retirement